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Judicial Control of Cash Tender Offers—A Few Practical Recommendations

After extensive debate and discussion in both academic and financial forums,¹ federal legislation directly regulating cash tender offers² was enacted in 1968. This legislation, commonly called the Williams Act,³ was designed to fill a "gap" in the protection of investors left by the Securities Exchange Act of 1934.⁴ The perceived lapse⁵ in protection arose when public investors in the stock of a company were not informed about the existence or motives of persons acquiring controlling interests in the stock of the company.

The solution to the problem has taken the form of disclosure requirements, basically divided into three areas: (1) post-acquisition disclosure⁶ by any person or group acquiring beneficial ownership of more than 5 percent of any class of equity securities registered pursuant

¹ Compare Brudney, *A Note on Chilling Tender Solicitations*, 21 *RUTGERS L. REV.* 609 (1967) (hereinafter cited as Brudney); Manne, *Mergers and the Market for Corporate Control*, 73 *J. POL. ECON.* 110 (1965) (hereinafter cited as Manne); Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 *DUKE L.J.* 231 (hereinafter cited as Manne's Reply); and Shtein, *Some Legal Aspects of Company Takeovers in Australia*, 5 *U. QUEENSLAND L.J.* 47 (1965) with Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 *BUS. LAW.* 149 (1966). See generally Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 *HARV. BUS. REV.* 135 (Mar.-Apr. 1967).

² A tender offer may be defined as a public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities.

Aranow & Einhorn, *Essential Ingredients of the Cash Tender Invitation*, 27 *BUS. LAW.* 415 (1972).

This note will deal only with cash tender offers. Exchange offers (stock-for-stock) and stock tender offers are regulated by provisions of the Securities Act of 1933, 15 *U.S.C.* §§ 77a-aa (1970), since they are classified as "sales" of securities. Cash tender offers, on the other hand, are regulated exclusively by the Williams Act, 15 *U.S.C.* §§ 78m(d)-(e) and n(d)-(f) (1970), and the rules promulgated thereunder.

The parties to a cash tender offer (or takeover bid) are the target company (management, incumbent management), the shareholders (offerees) of the target company, and the tender offeror (bidder, offeror, raider).

³ Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454, amending 15 *U.S.C.* §§ 78m-n (1964) (codified at 15 *U.S.C.* §§ 78m(d)-(e) and n(d)-(f) (1970)).

⁴ 15 *U.S.C.* §§ 77b-e, j, k, m, o, s, 78a-o, o to -3, p-hh (1970).

⁵ Much of the debate surrounding the proposed legislation dealt not with the type or extent of regulation, but rather whether regulation was needed at all. Compare Cohen, *supra* note 1, with Manne's Reply, *supra* note 1.

⁶ 15 *U.S.C.* § 78m(d) (1970). Within ten days after the acquisition, disclosure must be made to the issuer of the security, to each exchange where the security is traded, and to the Commission. Exceptions to this requirement are found in 15 *U.S.C.* § 78m(d) (5) (1970) (specific exemption by the Commission) and in 15 *U.S.C.* § 78m(d) (6) (B)

to section 12,⁷ (2) disclosures preceding and during a tender offer⁸ for more than 5 percent of any class of equity securities registered pursuant to section 12,⁹ and (3) a general antifraud provision calling for full and nonmisleading disclosure of material facts when making any public recommendations or solicitations for or against any tender offer.¹⁰ The Act also provides various protective devices including pro rata acceptance of shares,¹¹ equal payment to all tendering shareholders¹² and limited withdrawal of tendered shares.¹³

This note will review the concept of "material" disclosures required by this Act, as developed in recent contested tender offers, and will suggest remedies more consistent with the purposes of the Act than the remedies granted in those contests.¹⁴ Specifically, this note will deal with the necessities of completing tender offers on schedule, will discuss the economic and informational needs of the parties involved, and will suggest the integration of tender offer disclosure standards into the overall plan of investor protection.

THE WILLIAMS ACT

The underlying premise of the disclosure requirement as part of the investor protection scheme is that investors must be given the op-

(1970) (total acquisitions [including this acquisition] not exceeding 2 percent of a class of security during the preceding 12 months).

⁷ 15 U.S.C. § 78l (1970), discussed *infra* notes 65-66 & text accompanying.

⁸ 15 U.S.C. § 78n(d) (1970). Exceptions to this disclosure requirement are found in 15 U.S.C. §§ 78n(d)(8)(A)-(C) (1970) which deal with, respectively, acquisitions (including acquisitions pursuant to this offer) totalling not more than 2 percent of a class of security during the preceding 12 months, acquisitions by the issuer, and acquisitions specifically exempted by the Commission.

⁹ 15 U.S.C. § 78l (1970).

¹⁰ 15 U.S.C. § 78n(e) (1970). This section applies to any tender offer, not just those in which the target is a section 12 reporting company. Its application, then, is not limited to those filings, solicitations or recommendations which, as discussed below, are subject to review by the Securities and Exchange Commission (the Commission).

¹¹ 15 U.S.C. § 78n(d)(6) (1970).

¹² 15 U.S.C. § 78n(d)(7) (1970).

¹³ 15 U.S.C. § 78n(d)(5) (1970). This section reads:

Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time until the expiration of seven days after the time definitive copies of the offer or request or invitation are first published or sent or given to security holders, and at any time after sixty days from the date of the original tender offer or request or invitation, except as the Commission may otherwise prescribe by rules, regulations, or order as necessary or appropriate in the public interest or for the protection of investors.

¹⁴ None of the proposals or suggestions made will call for statutory or regulatory amendments. All that will be needed is a correction in the interpretation of the statutory language and a greater willingness to exercise equitable powers to protect shareholder interests.

portunity to see and evaluate relevant data so that they may make an informed investment decision based on past, present, and future performance of the company and its stock.

The Williams Act amended section 13 of the Securities Exchange Act¹⁵ to require disclosure after the acquisition of "control."¹⁶ The Act also amended section 14 to require disclosure by the bidder before a tender offer.¹⁷ The regulations under both sections require the filing of Schedule 13D¹⁸ as the first step toward meeting the statutory disclosure requirements.

Schedule 13D outlines the information to be supplied to the SEC. Included on this schedule are

(1) identification of the security and issuer affected or to be affected by the acquisition;

(2) identity and background of the person filing the statement (this item deals specifically with the name, address, occupation or business, and criminal record of the person filing the statement);

(3) source and amount of funds to be employed for financing the acquisition or offer;

(4) the purpose of the transaction (especially requested by this item are any plans or proposals to liquidate, sell assets, merge, or make any other major changes in the business or organization of the issuer);

(5) current rights or interests in the security of the issuer;

(6) contracts, arrangements or understandings with respect to the securities;

(7) persons employed or to be compensated for making solicitations or recommendations for the offer;

(8) copies of all public invitations or advertisements.

¹⁵ Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454, amending 15 U.S.C. § 78m (1964) (codified at 15 U.S.C. §§ 78m(d)-(e) (1970)).

¹⁶ Acquisition of 5 percent of any class of equity security is deemed by the statute to be sufficient to present potential control or influence. The Williams Act was amended by the Act of December 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497, (codified at 15 U.S.C. § 78m(d)(1)), to lower the level of acquisition from 10 percent to 5 percent to trigger the reporting requirements. A thorough discussion of this reporting requirement is presented in Robinson & Mahoney, *Schedule 13D: Wild Card in the Takeover Deck*, 27 BUS. LAW. 1107 (1972).

¹⁷ Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454, amending 15 U.S.C. § 78n (1964) (codified at 15 U.S.C. § 78n(d) (1970)).

¹⁸ 17 C.F.R. § 240.13d-101 (1974).

15 U.S.C. § 78n(d)(1) (1970) requires divulgence of the information specified in 15 U.S.C. § 78m(d) (1970) plus additional information as prescribed by the Commission. Section 78m(d) provides general requirements and delegates to the Commission the authority to prescribe rules and regulations. Accordingly, the Commission has established Schedule 13D as the basic reporting guide.

In addition, the tender offeror is required to present substantially all of the Schedule 13D information to the persons being solicited¹⁹ and is permitted to present additional information²⁰ that does not violate the Act's antifraud provision.²¹ Also, the offeror must specify the exact terms of the offer.

Schedule 14D,²² which is to be filed by certain persons (including management) making solicitations or recommendations for or against a tender offer,²³ closely parallels items 1, 6 and 7 of Schedule 13D. It also requires copies of all solicitations or recommendations made to the public.²⁴

Section 14(e), the general antifraud provision, underlies all of these filings, solicitations and recommendations; making it

unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor

¹⁹ 15 U.S.C. § 78n(d)(1) (1970) and 17 C.F.R. § 240.14d-1(c) (1974).

²⁰ 17 C.F.R. § 240.14d-1(d) (1974).

²¹ 15 U.S.C. § 78n(e) (1970).

²² 17 C.F.R. § 240.14d-101 (1974).

²³ 17 C.F.R. § 240.14d-2 (1974) lists communications to which the rules do not apply.

Included on this list are

[t]he furnishing of information and advice regarding a tender offer to customers or clients by attorneys, banks, brokers, fiduciaries or investment advisers, who are not otherwise participating in the tender offer or solicitation, on the unsolicited request of a person or pursuant to a general contract for advice to the person to whom the information or advice is given,

17 C.F.R. § 240.14d-2(e) (1974), and

[a] communication from an issuer to its security holders which does no more than (1) identify a tender offer or request or invitation for tenders made by another person, (2) state that the management of the issuer is studying the matter and will, on or before a specified date (which shall be not later than 10 days prior to the date specified in the offer, request or invitation, as the last date on which tenders will be accepted, or such shorter period as the Commission may authorize) advise security holders as to the management's recommendation to accept or reject the offer, request or invitation, and (3) request security holders to defer making a determination as to whether or not they should accept or reject the offer, request or invitation until they have received the management's recommendation with respect thereto.

17 C.F.R. § 240.14d-2(f) (1974). 17 C.F.R. § 240.14d-4(a) (1974), which requires the filing of Schedule 14D, also provides, in relevant part,

[t]hat this section shall not apply to (1) a person required by § 240.14d-1(a) to file a statement, or (2) a person, other than the issuer or the management of the issuer, who makes no written solicitations or recommendations other than solicitations or recommendations copies of which have been filed with the Commission pursuant to this section or § 240.14d-1.

²⁴ 17 C.F.R. § 240.14d-101, Item 4 (1974).

of any such offer, request, or invitation.²⁵

Since the passage of the Williams Act, the courts have been struggling with questions of definition and delineation in determining which disclosures or omissions fall within the borders of "material fact" required by the statute. During 1973 and 1974, courts have had numerous opportunities to face the question.²⁶ A pattern emerged: the offering company was held to a much stricter standard of material disclosure than was the incumbent management. Preliminary injunctive relief, often sufficient to effectively destroy a tender offer, was readily available to enforce compliance.²⁷ Contrary to the expressed intent of the leg-

²⁵ 15 U.S.C. § 78n(e) (1970).

²⁶ See *Missouri Portland Cement Co. v. Cargill, Inc.*, [Current] CCH FED. SEC. L. REP. ¶ 94,595 (2d Cir. June 10, 1974), discussed *infra* note 120; *Ronson Corp. v. Liquifin AG* 497 F.2d 394 (3d Cir.), *aff'g* 370 F. Supp. 597 (D.N.J. 1974), *vacating on remand from* 483 F.2d 846 (3d Cir.), *aff'g* Civ. A. No. 785-73 (D.N.J., July 5, 1973) (unreported order granting injunction); *Corenco Corp. v. Schiavone & Sons*, 488 F.2d 207 (2d Cir. 1973), *modifying* 362 F. Supp. 939 (S.D.N.Y.), discussed *infra* notes 33 and 72; *Gulf + Western Indus. v. Great Atlantic & Pacific Tea Co.*, 476 F.2d 687 (2d Cir.), *aff'g* 356 F. Supp. 1066 (S.D.N.Y. 1973), discussed *infra* notes 86, 99, 125-26 & text accompanying; *Sonesta Int'l Hotels Corp. v. Wellington Associates*, 483 F.2d 247 (2d Cir.), *rev'g* [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,007 (S.D.N.Y. 1973), discussed *infra* notes 91-100 & text accompanying; *Columbia Ribbon & Carbon Mfg. Co. v. Kapralos*, 374 F. Supp. 500 (E.D.N.Y. 1974); *Orbanco, Inc. v. Security Bank*, 371 F. Supp. 125 (D. Ore. 1974); *Cauble v. White*, 360 F. Supp. 1021 (E.D. La. 1973); *Elco Corp. v. Microdot Inc.*, 360 F. Supp. 741 (D. Del. 1973); *General Host Corp. v. Triumph American, Inc.*, 359 F. Supp. 749 (S.D.N.Y. 1973), discussed *infra* notes 76, 77-90 & text accompanying; *Mosinee Paper Corp. v. Rondeau*, 354 F. Supp. 686 (W.D. Wis. 1973); and *Texasgulf, Inc. v. Canada Dev. Corp.*, 366 F. Supp. 374 (S.D. Tex. 1973), *appeal docketed*, No. 73-3137, 5th Cir., Sept. 13, 1973, *temporary restraining order dissolved*, unreported order, Oct. 10, 1973, on file with INDIANA LAW JOURNAL, *appeal dismissed per stipulation of the parties*, unreported order, Dec. 6, 1973, on file with INDIANA LAW JOURNAL, discussed *infra* notes 101-16 & text accompanying.

²⁷ In 1973, nine cash tender offers were contested in the federal courts alleging violations of the Williams Act. See note 26 *supra*. All nine offers were met with, at a minimum, temporary restraining orders. This situation is in marked contrast to the first years of regulation under the Williams Act when courts were reluctant to enjoin the offers. Compare *Sonesta Int'l Hotels Corp. v. Wellington Associates*, 483 F.2d 247 (2d Cir. 1973):

Thus, in the normal situation, when it appears likely that the offer may contain materially misleading statements or omissions as made, the interest of the shareholders and of the public in full disclosure of relevant circumstances renders preliminary injunctive relief an appropriate method of remedying the deficiencies in disclosure before the offer is consummated.

Id. at 250-51 (emphasis added) with *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969):

[w]e do not mean at all that interlocutory relief should be given lightly. To the contrary, district judges must be vigilant against resort to the courts on trumped-up or trivial grounds as a means for delaying and thereby defeating legitimate tender offers.

See generally Binder, *The Securities Law of Contested Tender Offers*, 18 N.Y.L.F. 569, 603 (1973). See also Note, *The Courts and the Williams Act: Try a Little Tenderness*, 48 N.Y.U.L. REV. 991 (1973).

isolation, the courts have tipped the balance to favor management and have used, improperly,²⁸ the issue of material disclosure as the basis for enjoining tender offers.

THE NATURE OF TENDER OFFERS

Tender offers can serve useful purposes and can have important social consequences. An investment-oriented bidder may see what it assesses to be a low-side disparity between the market price of a stock and the potential price if assets were fully and efficiently utilized or divested. A change of control via a tender offer may eliminate inefficiencies such as an accumulation of idle cash; an operation that could be made more profitable if old, nonproducing assets were divested; or just bad management. The change of control can also create new efficiencies by opening up possibilities of a profitable merger.²⁹

On the other hand, an offer may be made purely to raid or liquidate assets to the immediate benefit of the raider and at the expense of the public shareholders' long-run investment. Or, a takeover may be attempted to eliminate, absorb, or control a competitor.

The consequences of "raiding" instigated the call for legislative action to fill the "gap" in investor protection.³⁰ The benefits of efficient management inspired the restriction of legislative regulation.³¹

Implicit in the passage of the statute requiring only disclosure of material information is the Congress' conclusion that investor protection does not demand the prohibition of changes of control via tender offers. Indeed, Senator Williams declared that he had made every effort in his bill to balance the interests of the management, the shareholders, and the offeror.³² These interests are not merely speculative or theoretical but are founded in economic reality and practicality.

BUSINESS PRACTICALITIES OF COMPLETING A TENDER OFFER ON SCHEDULE

From the Offeror's Perspective

Throughout a tender offer, management of the target is in the driver's seat. Management can legitimately release sales and earnings

²⁸ See text accompanying notes 41-44 *infra*.

²⁹ See Brudney, Manne, Manne's *Reply*, Shtein, Hayes & Taussig, *supra* note 1.

³⁰ See Senator Williams' speech introducing S. 2731, 89th Cong., 1st Sess. (1965), 111 CONG. REC. 28257 (1965), a predecessor of the present statute.

³¹ See 113 CONG. REC. 854 (1967).

³² *Id.* The bill's co-sponsor, Senator Kuchel, continued to view the bill as a method of eliminating tender offers, feeling that raiders and looters would be deterred if they were no longer able to hide behind a "cloak of secrecy." *Id.* at 857-58.

reports, issue public relations press announcements, arrange defensive mergers, dispose of or invest attractive assets, announce expansion programs, announce dividends, split the stock, or engage in a variety of other activities to bolster stockholder support and influence the market's evaluation of the value of the target stock.³³

Limitation of management activity comes primarily from the anti-fraud³⁴ and antimanipulative³⁵ provisions of the Securities Exchange Act.³⁶ For the most part, these limitations deal with direct attempts to manipulate or circumvent normal market trading in the stock. Management, then, is generally left free to carry out "normal operations" of the business.

A tender offer is ordinarily programmed to have a very short duration, usually from two to six weeks.³⁷ In almost all cases, the bidder attaches a premium price to the stock to make the offer attractive to a large number of holders.³⁸ The reason for the short duration and the premium price is to prevent the offer from being defeated by management's defensive activity.³⁹ Compilation of data or evaluation of investment/divestment opportunities by management may require extensive

³³ See Brudney, *supra* note 1, at 619, and Hayes & Taussig, *supra* note 1. See also *Corenco Corp. v. Schiavone & Sons*, 362 F. Supp. 939, 943-44 (S.D.N.Y. 1973), where management's defensive tactics can be summarized as including:

(1) a letter to stockholders urging them to take no action pending a thorough study by management;

(2) a second letter stating that the offer price was "inadequate";

(3) a declaration of a 30 cents per share regular quarterly dividend and an extra 25 cents per share cash dividend and a 10 percent stock dividend payable to holders of record after the scheduled expiration date of the tender offer;

(4) a press release announcing these dividends;

(5) a press release summarizing second quarter operations;

(6) a press release summarizing the allegations in the litigation;

(7) a letter to each shareholder discussing the allegations, the dividend declaration, and stating that the dividend would reduce the offer price; and

(8) hundreds of telephone calls to shareholders urging them to reject the offer.

³⁴ 15 U.S.C. § 78j(b) (1970).

³⁵ 15 U.S.C. § 78i (1970). For a full explanation of the antifraud and antimanipulative provisions see Jacobs, *Regulation of Manipulation by SEC Rule 10b-5*, 18 N.Y.L.F. 511 (1973).

³⁶ Other limitations may also arise under the blue sky laws and insider-trading rules.

³⁷ The schedule established by the offeror also includes a starting time for the offer. The timing may be arbitrary; it may be based on the availability of an attractive target asset; or it may be based on a consideration of several factors such as the current market price of the stock, historic price action of the stock, the magnitude of institutional holdings, the trading activities in the target stock and generally in the market, and the activities of arbitrageurs dealing in the target stock. See Hayes & Taussig, *supra* note 1, at 139-41.

³⁸ The size of the premium is based on the same considerations that determine the timing of the offer. *Id.*

³⁹ The Williams Act also provides an incentive to complete the offer quickly by allowing the withdrawal of tendered shares if they have not been purchased within 60 days of the original tender offer. 15 U.S.C. § 78n(d)(5) (1970), quoted *supra* note 13.

investigation over a long time span.⁴⁰ Any management action calling for stockholder approval may take even longer.

From Management's Perspective

Management is interested in seeing the swift failure of a tender offer. Management and the target company are primarily affected in four ways during an offer: (1) much of management's time and energy may be expended in dealing with the offer, (2) a great deal of corporate funds may be diverted to defensive activity or litigating the offer, (3) relations with suppliers and customers may be strained by uncertainty about the future operations of the company and its ability to meet contractual obligations, and (4) the stock price of the company is being subjected to aberrational influences. Therefore, the primary legitimate objective of the target management is to return quickly to business as usual.

From the Stockholder's Perspective

To the extent that the previously listed effects influence the value of the stockholder's investment, he is interested in the swift completion of the tender offer—preferably, a completion favorable to the management team that he thinks will give him the best return on his investment.

A tendering shareholder is also interested in avoiding interferences affecting the status of his "sale." Temporary injunctions or delays in the schedule may leave the tenderor in limbo, not knowing if his sale will be consummated or if he still owns the stock. This situation is especially harmful if profitable trading opportunities are foregone or if the shares are unavailable to apply as collateral for needed credit.

Litigation as a Tool to Disrupt Timing

Knowing that the timing of a tender offer is critical to its success, management may use its potentially most potent weapon—litigation.⁴¹ A simple preliminary injunction, by delaying and disrupting the offer

⁴⁰ The speed with which management can respond may be indicative of the efficiency of the management; i.e., no current data available or the absence of data on opportunities may indicate that management is not really paying optimal attention to benefits or problems facing the company. On the other hand, theoretically, a good management is constantly up to date and working on prospects and problems.

⁴¹ See Hayes & Taussig, *supra* note 1, at 146. Management may also subject itself to litigation by refusing to supply the bidder with lists of stockholders. If the offeror is already a stockholder with a "proper business purpose" for obtaining the list, it must eventually be turned over, but the delaying tactic is useful. See Wander, *Selecting Targets and Shaping Strategy in Corporate Take-overs: Securities Law Considerations*, 24 Sw. L.J. 593, 600 (1970).

schedule, may effectively destroy the offer by allowing time for successful management defensive tactics or the intervention of extrinsic conditions.⁴² If the Williams Act's delicately balanced objectives—full disclosure to investors but otherwise no discouragement of tender offers—are to be achieved, preliminary injunctive relief must not be readily available as a standard management defensive tactic.⁴³ Only in those cases where investor protection cannot be otherwise adequately obtained should a preliminary remedy, potentially destructive of the tender offer, be available.

When a court is presented with the initial petition for preliminary injunctive relief, it should consider, in weighing the equities, the time and expense invested by a tender offeror in evaluating and planning an offer before it decides to intercede on behalf of incumbent management and thereby upset the schedule of a tender offer. Fairness may also govern the extent to which management is allowed, via schedule-disrupting litigation, to implement the plans disclosed by the offeror and thereby deny the offeror his investment opportunity. From a social viewpoint, the investigator and planner of major changes may have the better ability to fully implement those major changes.⁴⁴ Continual judicial intervention may discourage tender offers and deprive the investors of the anticipated benefits.

A GUIDELINE FOR "MATERIALITY"—AN INTEGRATED DISCLOSURE RULE

An investor presented with a tender offer is called upon, essentially, to make a new investment decision based on changing circumstances in a current investment. The intent of Congress was not to make the decision for the stockholder, but to provide him with all the "material" information he would need to make his own decision.⁴⁵ "Materiality"

⁴² Consider the impact of a sudden, sharp upturn in the market, the announcement of a competing tender offer at a higher price, the arrangement of a merger between the target and another company, or a major change in interest rates or margin requirements that would disrupt the offeror's means of financing the offer.

Congress recognized the importance of the offer schedule. The legislation enacted speaks not of time lags or time spans, but only of shareholder-protection devices if the bidder voluntarily extends or modifies the offer.

⁴³ Judge Friendly, in *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1968), issued the warning: "[D]istrict judges must be vigilant against resort to the courts on trumped-up or trivial grounds as a means for delaying and thereby defeating legitimate tender offers."

⁴⁴ The person who plans major changes may have a better grasp of the scope and necessities of the interrelationships between facets of the plan. Also, an outsider, without longstanding loyalties and friendships, may be less restrained when divesting outmoded or unprofitable operations.

⁴⁵ But, when contemplating his decision to tender or not tender, he has an enigmatic need for information and a paradoxical choice of action to take. The stockholder must

has been defined in many contexts, but the basic test can be summarized as whether a reasonable investor might (or would) have considered the facts in question to be important in the making of his decision.⁴⁶ The pivotal points in this test are the standards of "reasonableness" to be applied and the requisite propensity to affect the decision.⁴⁷ A third variable will be the level of culpability required of the defendant before an action can be maintained against him.⁴⁸

determine not only the relative desirability of the competing management teams and the compensation provided by the premium, but also the probability of success or failure of the offer (how many other shareholders will tender based on their determinations). On the one hand, the shareholder may prefer the raider, therefore wanting to retain his status as a minority shareholder. On the other hand, he may prefer present management and want to sell his stock at an attractive price before the takeover. In either case, his decision will have an adverse effect on the outcome he desires (changing or retaining managements).

⁴⁶ See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54, *rehearing denied*, 407 U.S. 916 (1972) (Rule 10b-5); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970) (proxy solicitations); *Symington Wayne Corp. v. Dresser Indus.*, 383 F.2d 840, 843 (2d Cir. 1967); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). But cf. *General Time Corp. v. Talley Indus.*, 403 F.2d 159, 162 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969), where the court, after distinguishing the contested election in this case from proxy solicitations and prospectus disclosures, stated:

The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course.

The court based its distinction on the fact that a contested election is a *choice between management teams* and is decided by more subjective criteria than the mathematical analysis of proposed transactions or the market attractiveness of stock.

⁴⁷ An unresolved dispute exists as to whether the misinformation must cause the investor to act wrongly ("would" affect the decision), or whether it must merely present him with the opportunity to make the wrong decision ("might" affect the decision). See note 48 *infra*.

⁴⁸ If the public policy is to vigorously protect investors, then actions will be allowed for any *negligent* omissions or misstatements that *might* affect the investor's decision. However, judicial interpretations of some of the applicable statutes and regulations concerning disclosure have limited the promotion of this preferred policy. For example, Rule 10b-5, 17 C.F.R. § 240.10b-5 (1974), covering *voluntary* disclosures, utilizes "evil" language (devices, schemes, or artifices to defraud). Because the "evil" sounding language limits the scope of the Commission's rulemaking authority and because of a desire to promote voluntary disclosure, private rights of action have been limited to those cases where *scienter* can be shown. Yet, only minimal causation ("might" affect the decision) needs to be shown. Cf. *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973).

At the opposite end of the spectrum is Rule 14a-9, 17 C.F.R. § 240.14a-9 (1974), which covers *required* disclosures in proxy statements. The language of this rule is very broad and does not carry with it the "evil" connotations of Rule 10b-5. Because of the general language of Rule 14a-9, *negligent* omissions or misstatements are actionable. However, since the disclosures are *required* and since negligence is actionable, the courts have decided to avoid placing unduly harsh burdens on the potential defendant and have thus held that an action would lie only if the omission or misstatement *would* affect the decision. *Gerstle v. Gamble-Skogmo, Inc.*, *supra*.

The Williams Act antifraud provision, section 14(e), lies somewhere between Rule 10b-5 and Rule 14a-9. It contains the "evil" language of Rule 10b-5 and the general

Since response to a tender offer is, in most cases, an investment decision, regulation under the Williams Act should fit coherently into the entire scheme of disclosure in investment regulation. It is important to note at the outset that disclosure of plans and proposals break with an SEC tradition prohibiting projections and other references to the future unless they are grounded in a certain level of present intent and certainty of occurrence. The traditional rules developed under the basic securities laws should, at least as applied to currently available information, provide relevant precedent for the specificity of any disclosure required or contributed and should define to whom the disclosures are directed. The traditional exceptions to the traditional rules should also provide a basis for the allowability of information regarding plans and proposals. Therefore, a discussion of these rules and exceptions is necessary before enforcement of the Act can be considered.

*The Securities Act of 1933*⁴⁹

The Securities Act furnishes the first set of regulations concerning disclosures with respect to the issuance of a security. Four aspects of this statute and the rules promulgated thereunder have particular relevance to this discussion. First, "material" is defined as a term to *limit* the disclosures required: disclosures are limited to "those matters as to which an average prudent investor ought reasonably to be informed"⁵⁰ Second, plans, proposals or other words relating to the future refer only to present intentions.⁵¹ Third, the issuer need only disclose information known or reasonably available and may omit information if obtaining it would involve unreasonable effort or expense.⁵² Fourth, "material" is apparently a much broader categorization than "necessary for the protection of investors" because some material contracts can remain secret if disclosure would impair their value and not be necessary for protection of investors.⁵³

language of Rule 14a-9. Also, section 14(e) covers both required and voluntary disclosures. *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341 (1973), held that, like Rule 10b-5, section 14(e) also imposes a *scienter* element. *Id.* at 363. *See also id.* at 393 (Gurfein, J., concurring). However, without discussing the finer points of the issue, the court applied a test of whether the investor's decision *would* be affected. The same court later stated in *Gerstle v. Gamble-Skogmo, Inc.*, *supra* (construing Rule 14a-9), that a "would" test was appropriate in that case because *negligence* was actionable. But, by failing to speak for all cases, the court implied that a "might" test may be appropriate when *scienter* was a required element of the action. *Id.* at 1301-02.

⁴⁹ 15 U.S.C. §§ 77a-aa (1970).

⁵⁰ 17 C.F.R. § 230.405(l) (1974).

⁵¹ 17 C.F.R. § 230.407(c) (1974).

⁵² 17 C.F.R. § 230.409 (1974).

⁵³ 17 C.F.R. § 230.485 (1974).

The aforementioned regulations apply to the registering of new securities and to the prospectuses presented to potential investors.⁵⁴ They govern the initial stages of placing in the market a security that may later become the target of a tender offer. Taken as a whole, the registration and prospectus regulations provide a restrictive concept of materiality and limit the information that must or can be disclosed. This restrictive concept is carried forward in the Securities Exchange Act passed the following year.⁵⁵

*The Securities Exchange Act of 1934*⁵⁶

The Exchange Act encompasses most aspects of trading in securities, particularly with an end towards ensuring fair and open dealing for the protection of investors. As under the Securities Act, the Exchange Act regulations define "materiality" as a factor *limiting* the extent of disclosure necessary to protect an "average prudent investor."⁵⁷

⁵⁴ 15 U.S.C. § 77e (1970).

Consideration of Securities Act registration and prospectus disclosures has attained particular appropriateness since the promulgation of Rule 145, 17 C.F.R. § 230.145 (1974). The thrust of this rule is to make applicable the Securities Act registration requirements when there is submitted to security holders a plan or agreement pursuant to which such holders are required to elect, on the basis of what is in substance a new investment decision [*i.e.*, mergers, consolidations, or sales of assets], whether to accept a new or different security in exchange for their existing security.

Id., preliminary note. Such matters were previously not considered a "sale" of securities, 17 C.F.R. § 230.133 (1971), and were, thus, covered only by the disclosure requirements for proxy solicitations under the Securities Exchange Act, 15 U.S.C. § 14(a) (1970).

⁵⁵ See notes 56-68 *infra* and text accompanying.

⁵⁶ 15 U.S.C. §§ 77b-e, j, k, m, o, s, 78a-o, o to -3, p-hh (1970).

⁵⁷ 17 C.F.R. § 240.12b-2(j) (1974). An important exception to the "average prudent investor" standard arises under the insider trading restrictions enforced under section 10(b), 15 U.S.C. § 78j(b) (1970), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1974). *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), expanded the category of "reasonable investor" to include even chartists and speculators, inasmuch as they needed the same protection as conservative investors when both groups were trading with insiders without the benefit of the knowledge available to the insiders.

Rule 10b-5 is distinguishable from its progeny, section 14(e), because insider trading differs from a tender offer in an extremely important aspect—a person in a peculiar position to have knowledge (the insider) is attempting to act on information for his own profit by covertly circumventing normal market value-adjustment machinery—buying or selling on the basis of information before that information becomes public. On the other hand, a tender offeror puts the investment market on notice that changes are forthcoming and invites the intervention of market activity and speculation. In other words, an insider trades in a false atmosphere of normality in the market for the stock. Conversely, the tender offer creates an abnormal atmosphere that invites investigation, putting the particular investor on notice to seek out other information that he alone "might" require in making his investment decision; whereas the withholding or misstatement of inside information deprives all outside investors the opportunity to investigate thoroughly the entire realm of information to determine for themselves what information is material. Therefore, for Rule 10b-5 purposes, the scope of "materiality" must be much broader to

Under the Securities Exchange Act general guidelines for measuring the materiality of information as pertinent to protecting investors may be derived from the annual reporting requirements. Annual reports submitted to the shareholders provide the primary basis for evaluating the worth of an investment by presenting factual data and managerial interpretations from which the stockholder can calculate and determine his course of action in regard to increasing, maintaining or trading his holdings.

Section 14⁵⁸ provides for annual reporting to the shareholders, subsection (a) applying when proxies are solicited and subsection (c) being applicable in the absence of proxy, consent or authorization solicitation. Schedules 14A⁵⁹ and 14C,⁶⁰ required for compliance with section 14, prescribe the type and extent of disclosures.

Items 14 of Schedules 14A and 14C, dealing with mergers, consolidations and acquisitions, are particularly relevant because such matters are also deemed to involve an election of officers under most circumstances.⁶¹ Generally, the issuer is required to furnish a brief *outline* of the material features of the plan⁶² and *brief* descriptions of the other party's business and financial standing as are "essential to an investor's appraisal of the action proposed to be taken."⁶³ It is clear from these requirements that detailed itemizations of all aspects of the proposal are not required as necessary for the protection of investors.

Items 16,⁶⁴ dealing with proposals to acquire or dispose of property, require a more stringent response to questions in areas that would have an immediate impact on the evaluation of the stock; they call for statements of the nature and amount of consideration to be paid or received and an outline of facts bearing on the fairness of the consideration.

Further, under the Exchange Act, one of the two ways a company can achieve section 12 reporting status,⁶⁵ and thus gain the protections

encompass all investors who are deprived of any accurate information upon which to base their decisions. See also note 48 *supra*.

⁵⁸ 15 U.S.C. §§ 78n(a), (c) (1970).

⁵⁹ 17 C.F.R. § 240.14a-101 (1974).

⁶⁰ 17 C.F.R. § 240.14c-101 (1974). Item 1 of this schedule requires that all the information required by Schedule 14A (except Items 1, 3, and 4) be furnished. Because of this cross-reference, citations to Schedule 14C will include by reference the itemization of Schedule 14A.

⁶¹ 17 C.F.R. § 240.14a-101, note A (1974).

⁶² 17 C.F.R. § 240.14a-101, Item 14(a) (1974).

⁶³ 17 C.F.R. § 240.14a-101, Item 14(b) (1974).

⁶⁴ 17 C.F.R. § 240.14a-101, Item 16 (1974).

⁶⁵ The other way is to have assets exceeding \$1,000,000 and a class of equity security (other than an exempted security) held by 500 or more persons. 15 U.S.C. § 78l(g) (1970).

of the Williams Act, is to be listed on an organized exchange.⁶⁶ Many of these markets have elaborate rules including disclosure requirements which provide for even more current information flows. For example, the New York Stock Exchange *Company Manual*⁶⁷ makes clear that:

A corporation whose stock is listed on the New York Stock Exchange is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for securities. This is one of the most important and fundamental purposes of the listing agreement which each corporation enters into with the Exchange.⁶⁸

In other words, the NYSE requires that the management make information available as soon as it is no longer possible to maintain secrecy within the highest levels of the management. The purpose of this requirement is to keep all material information in front of the public insofar as it might affect stock prices and values.

A Viable Standard

The foregoing discussion suggests that the investor-protection scheme envisioned by Congress and the SEC was aimed toward an average prudent investor who would make decisions based on an overall view of a corporation's history and prospects. Disclosure of information material to and necessary for the making of an informed decision is required by the statutes and regulations and by the rules of the stock exchanges.

The similarities between merger or consolidation situations and tender offer situations provide sufficient basis for using the regulation of the former as an interpretive guide for regulation of the latter. Both situations represent fundamental changes in the corporation, its structure and its management. More importantly, both situations arise during the operating life of the corporation, and thus during regular information flows from management.⁶⁹ Because investor-held knowledge of

⁶⁶ 15 U.S.C. § 78I(a) (1970). By statute, "exchange" means any organization, association, or group of persons . . . which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing . . . the functions commonly performed by a stock exchange as that term is generally understood

15 U.S.C. § 78c(a) (1) (1970).

⁶⁷ See the discussion of this looseleaf guide in D. VAGTS, *BASIC CORPORATION LAW* 585 (1973).

⁶⁸ *Id.* (footnote omitted).

⁶⁹ Most mergers, consolidations or tender offers occur during aberrational phases of the company's history, which would suggest that management may be providing a

this regular information is presupposed, regulation of both situations requires only a minimum level of new disclosures and permits additional disclosures by those persons or groups promoting the changes. Both situations also provide the machinery and limitations for disclosure by those persons or groups opposing the change.⁷⁰ In all, both situations may involve an adversary atmosphere wherein both sides seek to promote their own interests and serve as watchdogs over their opposition—with the SEC and the courts available to oversee the contest and protect the interests of the stockholders in the middle.

The previously discussed areas of regulation, the Securities Act and the Securities Exchange Act, should have operated to keep information about current operations, assets, or opportunities of the target company in the hands of the stockholders via the medium of management disclosure of all information material to the investment decision. If, however, management has deemed information to be immaterial or not requiring detailed disclosure before a tender offer, it is difficult to comprehend, in most cases, how this information could suddenly become more important to the investor during or after a tender offer. The regulations, the transilient nature of investments, and the investors' constant need for information that will affect the value of their investments will have required the disclosure of all material information.

Because of management's continuing obligation to provide current material information, an offeror should normally have no need to reiterate information provided by management⁷¹ but should be required to provide substantially similar information about itself if that information was not previously publicly available.⁷² If, however, management has failed in its obligation to disclose material information regarding the internal operations of the company, the SEC's enforcement

higher than normal information flow to soothe stockholder concern or to combat the aberrational influences.

⁷⁰ An important distinction between merger or consolidation situations and tender offer situations is the amount of dissenting information allowed. Rules 14a-7 and -8, 17 C.F.R. §§ 240.14a-7, -8 (1974), limit, in a practical sense, the amount of information that can be presented in opposition to a proposal for which proxies are solicited.

On the other hand, the Williams Act and supporting regulations place no limits at all on the extent of dissenting information. In fact, the Act may allow management to transcend traditional limits on plans and projections if the Act is read to permit, if not require, equivalent disclosures by both sides during communications with shareholders.

⁷¹ One possible exception may be those persons who recently bought into the target company without reviewing the available information.

⁷² See *Corenco Corp. v. Schiavone & Sons*, 362 F. Supp. 939 (S.D.N.Y.), modified, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,108 (S.D.N.Y.), *aff'd in part, remanded in part*, 488 F.2d 207 (2d Cir.), *on remand* [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,220 (S.D.N.Y. November 15, 1973), where, for the first time, the bidder, a closed corporation, was required to disclose financial information about itself.

powers or the court's equity jurisdiction can operate to supplant management's judgment and order disclosure by either side.⁷³ The important point to be drawn from management's prior failure to disclose is that the failure should not in itself be grounds for enjoining a tender offer. Quite the contrary, if the information is material to the investment decision, the courts can exercise their equitable powers to order the disclosure. If management has failed to perform its responsibility and has chosen not to make the disclosures as a defensive tactic, the courts should not necessarily deprive the offeror and the investors of their opportunities because of management's actions.

If the offeror is truly interested in the success of its offer, it may be willing to amend its offer information to include the newly available information. If this condition is met, the court has an alternative to unconditionally enjoining the tender offer. If the court deems it necessary and the offending party is willing, immediate disclosure may be ordered on the condition that the offer or recommendation will be enjoined if compliance is not forthcoming.⁷⁴ If satisfactory disclosure is made, the purpose of the Williams Act—adequate information to the investor—will have been fulfilled and no reason will exist to further enjoin the offer or recommendations.

To summarize, a strict scrutiny by the court of any alleged material omission or misstatement ought to be required in litigation seeking the enjoining of a tender offer. Standards for materiality, for both current operating conditions and plans and projections, should be drawn from the commonly understood principles administered under the Securities Act and the Exchange Act. A tender offer situation is simply another type of investment opportunity, and the potential holder or seller of shares needs the same basic information in all cases.

Secondly, if after this exacting scrutiny a court concludes that a bit of information omitted from or misstated in the tender offeror's solicitation is indeed material, the court should next consider whether the information has been, or under the relevant reporting requirements ought to have been, disclosed by management of the target. If not, disclosure by the tender offeror is clearly called for. But if management should have disclosed but did not, or did so too long ago or in some

⁷³ The SEC or the court could order management to clarify or complete earlier disclosure if the offeror cross-complained alleging misleading statements by management.

⁷⁴ It is important to distinguish this conditional injunction from that proposed in Note, *The Courts and the Williams Act: Try a Little Tenderness*, 48 N.Y.U.L. Rev. 991 (1973), which would enjoin first and then dissolve the injunction after satisfactory disclosure. *Id.* at 1016.

other context which does not provide adequate protection to the investor in this case, the court should balance the investor's need for the information against any probable harm to the offeror from an injunction disrupting the offer schedule. Weighed into this balance should be the likelihood of management disclosure of the information as a defensive tactic if the injunction is denied and the possibility of an equitable order requiring management to disclose the information.⁷⁵

Finally, if after this balancing process the court still concludes that disclosure by the offeror is required, consideration should be given to the possibility of a conditional injunction, enjoining the tender offer after, say, ten days unless the offeror satisfactorily discloses to the offeree stockholders. Such a conditional injunction, if appropriate, is a better recognition of the statutory purpose of the Williams Act—a finely tuned balance between providing adequate investment information and not unnecessarily discouraging tender offers. It may often be possible to provide the needed information without fatal disruption of the tender offer which could result from use of an unconditional preliminary injunction.

A CRITICAL EVALUATION OF RECENT DECISIONS

A review of several recent cases highlights the extent to which courts have tended to presume the materiality of information omitted or misstated by the offeror. These cases also illustrate that management of the target corporation has been able to protect itself by projecting a new aura of materiality onto information which it had previously considered immaterial or unnecessary for the protection of its shareholders. Conversely, those courts have undervalued the irreparable harm to the bidder and, quite often, have not even considered the impact on the investors.

The test now applied before a preliminary injunction can issue requires a showing of a

combination of probable success on the merits and the possibility of irreparable injury, *or* that [plaintiff] has raised serious questions going to the merits and that the balance of hardship is tipped sharply in its favor.⁷⁶

The tendency to presume "materiality" and to ignore whose duty it was in the first instance to disclose the information ensures that the plaintiff's

⁷⁵ See note 73 *supra* & text accompanying.

⁷⁶ *General Host Corp. v. Triumph American, Inc.*, 359 F. Supp. 749, 753 (S.D.N.Y. 1973) (emphasis in original).

allegations raise "serious questions going to the merits" and even guarantees "probable success on the merits" of any claim of material omissions or misstatements. Rather than using other equitable remedies, recent courts have opted for far-reaching temporary restraining orders followed by preliminary injunctions and often followed by injunctions pending appeals (regardless of who won on the merits at trial).

In *General Host Corp. v. Triumph American, Inc.*,⁷⁷ the target, Host, sought to enjoin the tender offer on grounds of violations of the Federal Communications Act,⁷⁸ violations of the Shipping Act,⁷⁹ and violations of the Office of Foreign Direct Investment rules (violations resulting if a successful tender offer transferred control to a foreign corporation). Host also alleged Triumph's failure to disclose foreign government control, intentions as to disposition of Host's liquid assets,⁸⁰ and that a "group" was behind the offer. Host further alleged violations of margin requirements.

After stating its test for issuing a preliminary injunction,⁸¹ "the Court . . . proceeded on the premise that relief should issue if Host has borne its burden on at least one of the issues raised."⁸² The court chose to consider the alleged section 14(e) violations, especially the matters of the liquid assets and foreign control.⁸³

This court stated:

The test for materiality requires that Host must establish that the facts omitted or misrepresented were material facts in the sense that a reasonable "prototype" investor might have considered them important in the making of his decision to tender or not tender in response to Triumph's tender offer.⁸⁴

The court found the omissions to be material—a just decision since the types of limitations and regulations to be violated would not be known to the investors nor would the investors normally consider them to be relevant to the continuation of the corporation.⁸⁵

⁷⁷ 359 F. Supp. 749 (S.D.N.Y. 1973) (hereinafter the parties will be referred to as Host and Triumph).

⁷⁸ 47 U.S.C. § 310 (1970).

⁷⁹ 46 U.S.C. §§ 808, 835 (1970).

⁸⁰ Host was an attractive target because it held \$35 million in cash and marketable securities left over after it liquidated 54 percent of Armour & Co. stock obtained in an unsuccessful tender offer.

⁸¹ See note 76 *supra* & text accompanying.

⁸² 359 F. Supp. at 753.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ A shareholder would not normally know the restrictions imposed upon a radio or shipping license. He would usually just consider these licenses to be part of the operation of the company. However, these restrictions become extremely relevant if

Ominously, this court quoted an earlier case out of context,⁸⁶ concluding that material misrepresentations were unlawful, should not be permitted and, therefore, that injunctive relief should issue without regard for the balancing and protection of the various interests involved.⁸⁷ This stance is directly contrary to the intent of the statute and the whole of securities law which is directed toward promoting disclosure and allowing free and open trading in securities. A more correct approach would have been to order disclosure of information relating to the various relevant regulations and allow the investors to decide for themselves whether they wanted to invest in a company subject to the restrictions and loss of assets.

Specifically rejecting Triumph's assertions that an injunction would allow time for others to make tender offers or that Host would have time to place obstacles in the way of a tender offer, the court concluded that Triumph would not be foreclosed from renewing its offer if vindicated at a trial on the merits.⁸⁸ Five days after Triumph announced its tender offer (while this action was awaiting hearing), another tender offer for Host was announced,⁸⁹ and six months later, Host was negotiating a merger with another company.⁹⁰

In *Sonesta International Hotels Corp. v. Wellington Associates*,⁹¹ Sonesta, the target, sought a preliminary injunction alleging that the bidder failed to disclose adequately (1) an ongoing litigation between them, giving rise to an unsatisfied judgment and another alleged debt totalling \$2.4 million; (2) the bidder's plan to defeat certain proposals which might lead to a two dollar per share tax-free distribution to shareholders; (3) the source of financing for the tender offer; (4) the probability that the target would be de-listed from the New York Stock

they cause the loss of the license and, thereby, force the abandonment of a major source of revenue to the company.

⁸⁶ The court quoted *Gulf + Western Indus. v. Great Atlantic & Pacific Tea Co.*, 476 F.2d 687, 698-99 (2d Cir. 1973), where that court held that there was no right to proceed with a tender offer unlawfully violating antitrust laws.

⁸⁷ 359 F. Supp. at 759.

This Court has determined that there is the probability that there has been an unlawful tender offer in that Host shareholders have not been honestly and fairly informed by Triumph. Triumph has no inherent right to proceed with an unlawful tender offer.

Id.

⁸⁸ *Id.* at 758-59.

⁸⁹ N.Y. Times, Mar. 21, 1973, at 59, col. 4.

⁹⁰ N.Y. Times, Oct. 3, 1973, at 59, col. 7; *id.*, Oct. 4, 1973, at 66, col. 2; *id.*, Oct. 11, 1973, at 70, col. 4. However, the negotiations were terminated without any reason given. *Id.*, Nov. 13, 1973, at 72, col. 4.

⁹¹ [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,007 (S.D.N.Y.), *rev'd*, 483 F.2d 247 (2d Cir. 1973). (The parties will be referred to as Sonesta and Wellington.)

Exchange if the offer were completely successful; and (5) the backgrounds and reputations of the bidders, namely that several of the bidder's buildings were allegedly used for massage parlors, pornographic film theaters and peep shows, and that this background would adversely affect the reputation and credit rating of the target.⁹²

The Second Circuit Court of Appeals, again quoting out of context, once more applied the theory that material omissions were unlawful and, therefore, dispositive of the question of whether a preliminary injunction should issue. This time the court added that there is a public interest to be protected.⁹³

The appellate court found that

[t]he most persuasive claim by Sonesta is that Wellington did not sufficiently disclose that it owed more than \$2.4 million to Sonesta and that this debt might be compromised on terms adverse to Sonesta shareholders if Wellington should succeed in acquiring control of Sonesta.⁹⁴

In fact, the "debt" owed was comprised of a \$500,000 undisputed claim and a judgment for \$1.89 million which was still on appeal.⁹⁵ Wellington did disclose that it intended to "influence the position taken by Sonesta" and that it was "possible that Sonesta will receive less than it would if Wellington does not acquire control of Sonesta."⁹⁶ The court required a numerical disclosure of the full amount at stake.⁹⁷ If the amount at stake was, indeed, material to the operation of the business and the value of Sonesta shares, this information should already have been made available to the shareholders by the management. Thus, Wellington's statement would have been sufficient to put the shareholders on notice of the extent to which share values could change.

Sonesta also claimed that Wellington failed to disclose that it planned to defeat two proposals to liquidate leasehold interests in two hotels. Such defeat would preclude potential benefits for the shareholders. Beneficial effects would occur only if the sales were successfully closed and Sonesta could obtain a favorable tax ruling. If those things occurred, anticipated extraordinary losses were expected to

⁹² A *New York Post* article had made the original damaging allegations. *Id.* at 254.

⁹³ *Id.* at 250-51. The court quoted *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 383 (1970), which was merely stating that stockholders have a private right of action against proxy fraud, independent of the "fairness" of the transaction.

⁹⁴ 483 F.2d at 251-52.

⁹⁵ The district court found that there was no "debt" owing until litigation was completed. [1973 Transfer Binder] at 94,059.

⁹⁶ 483 F.2d at 252 n.4.

⁹⁷ *Id.* at 252.

offset the gains from the sale and the gains could be distributed to shareholders. The court observed that "[n]o sound reason appears why the full circumstances of the possible defeat of the proposals . . . should not have been set forth in the offer in the first instance."⁹⁸ If the full circumstances of the proposal were actually material to the proxy vote that was to approve the sale, management should have already presented this information to the shareholders in the proxy and annual meeting materials. Failure of management to fully inform stockholders of all material facts surrounding their own proposal should not have been sufficient grounds for enjoining the tender offer.

Concerning Sonesta's claim that its reputation would be impaired and that this should have been disclosed, the facts show, and both courts acknowledged, that Wellington was the owner of a number of reputable hotels and that Wellington had instituted a suit for libel against the New York Post Company for making the harmful allegations. The appellate court decided that Sonesta's claim (and its repetition of the libel) emanated from "overzealousness."⁹⁹

⁹⁸ *Id.* at 253.

⁹⁹ *Id.* at 254.

An additional example of judicial unwillingness to apply the strict materiality standards to communications by the offeree management is seen in the lower court opinion in *Gulf + Western Indus. v. Great Atlantic & Pacific Tea Co.*, 356 F. Supp. 1066 (S.D.N.Y. 1973), where the bidder, G + W, sought to enjoin the target from violating section 14(e), alleging false and misleading statements and omissions of material facts. G + W specifically challenged a press release which stated that the offer price was "inadequate" and that the consummation of the offer "raises most serious questions under the antitrust laws." *Id.* at 1070. G + W also challenged a letter from A & P to its shareholders which gave a summary progress report, reiterated that the offer price was "inadequate" because of a book value of more than the offer price, repeated (without explanation) the antitrust charge and omitted any reference to previous losses, dividend declines, and the low market price of the stock. *Id.* at 1075-76.

The antitrust allegations are somewhat questionable. Charles Bluhdorn, board chairman and chief executive officer of G + W, also owned a controlling interest in Bohack Corporation, A & P's leading competitor in the New York City area. Prior to the tender offer, Bluhdorn and other G + W officers resigned from the board of Bohack and Bluhdorn placed his Bohack stock in a voting trust to be sold within one year if the tender offer were successful. G + W also had an established policy against reciprocal dealing. The district court settled the question in favor of A & P by stating that, although the claims were totally unproven, "[t]he Court is left, therefore, with a claim and an intuitive feeling that at sometime in the future the claim might be proven." *Id.* at 1073.

The district court also found that a bare claim of price inadequacy or a claim supported by a "book value" was not misleading because price is subjective and not only controlled by "mathematical formulae, but by the intuition or 'hunch' of the buyers and sellers of the stock" and by "the whims and caprice of the crowd." *Id.* at 1071. Management's letter to the stockholders not only reported record sales, but also implied a "turn-around" in earnings and ability to pay dividends. *Id.* at 1075-76. This was not the case. A & P experienced earnings losses through the next quarter and passed another dividend. *N.Y. Times*, Apr. 28, 1973, at 41, col. 2; *id.*, Apr. 13, 1973, at 57, col. 4. Book value is inherently misleading and is especially so when unaccompanied by explanations of valuation procedure. See *Herald Co. v. Seawell*, 472 F.2d 1081, 1092 (10th Cir. 1972);

In ordering a preliminary injunction against consummation of the tender offer unless Wellington disclosed all the facts found to be material, the Second Circuit held that

[t]he obligation is placed squarely on those making the offer in the first instance to disclose all material factors necessary to make *their offer* not misleading. That duty cannot be shifted to the shoulders of others.¹⁰⁰

In *Texasgulf, Inc. v. Canada Development Corp.*,¹⁰¹ the trial court had a solid grasp on the concepts and interests involved but lacked the creativity necessary to promote the purposes of the statute. The tender offer had come as a complete surprise to management.¹⁰² Texasgulf immediately summoned a board meeting and began issuing press releases, urging its shareholders not to act hastily but to wait until management had investigated the offer. No one at the board meeting questioned the legality or adequacy of the offer but merely determined to "stop the clock" to have time to organize their defense. A blank check was delivered to their attorney with instructions to find any method to buy time.¹⁰³ No Schedule 14D¹⁰⁴ was ever filed by management, nor were the shareholders ever informed as to management's evaluation of the deal. Texasgulf filed a petition on July 27 seeking a temporary restraining order and a hearing for a preliminary injunction alleging section 14(e) violations. Both were granted. CDC counterclaimed for a preliminary injunction, citing the Schedule 14D violation, and asked for a modification of the temporary order to allow receipt of the tendered shares by a depository. The modification was granted. One and one-half hours before the hearing, Texasgulf sought and received a one-day delay to amend its complaint to allege antitrust violations. On August 8 Texasgulf was preliminarily enjoined from communicating

D. VAGTS, BASIC CORPORATION LAW 112 (1973). Proper application of disclosure requirements would also require precision and accuracy when making or implying predictions of future growth and earnings of the company. If the district court had been truly interested in supplying investors with material information from which they could themselves make an investment decision, an order of correction or an injunction against further similar recommendations would have been appropriate in this case.

¹⁰⁰ 483 F.2d at 255.

¹⁰¹ 366 F. Supp. 374 (S.D. Tex. 1973) (hereinafter referred to as *Texasgulf*). (The parties will be referred to as Texasgulf and CDC.)

¹⁰² The tender offer was proposed to CDC's board of directors on July 23, 1973, and approved by the board the next morning. Texasgulf management was informed of the bid at 4:05 p.m. and CDC filed their Schedule 13D with the SEC at 4:40 p.m. At 5:30 p.m. the public announcement was released for publication on the next day. 366 F. Supp. at 384-85.

¹⁰³ *Id.* at 385.

¹⁰⁴ 17 C.F.R. §§ 240.14d-4, -101 (1974). See notes 22-24 *supra*.

with shareholders except in open court.¹⁰⁵ CDC was given permission to extend its tender offer and announce current progress. CDC at all times offered, and presented to the court, amended tender offers setting forth disclosures deemed necessary by Texasgulf.¹⁰⁶

The court found no basis for any of Texasgulf's allegations, but, as it said on one point, in reference to potential conflicts of interest arising from a successful takeover,

since so much was made of it during this hearing, and since CDC has offered to do equity and acknowledge it in its amended tender offer, this Court will agree that it should be disclosed.¹⁰⁷

On another point, the court found,

CDC could not reasonably have been expected to disclose this information because it was not available to them and could not have been discovered with reasonable effort since there was nothing in any of the public filings to inform CDC of this possible problem CDC cannot be held responsible to disclose the contents of Texasgulf's private files.¹⁰⁸

"However," the court said, "now that the information has come to light it should be put before the stockholders as an amendment to the tender offer"¹⁰⁹

On September 4, the court extended the temporary restraining order against CDC for ten days to allow CDC time to amend its offer and for Texasgulf to apply for an appeal.¹¹⁰ On September 12, Texasgulf announced a \$46 million expansion program¹¹¹ and on September 14, the Fifth Circuit Court of Appeals extended the order against CDC pending Texasgulf's appeal to be heard on October 10.¹¹² Later, Texas-

¹⁰⁵ 366 F. Supp. at 388 n.11.

¹⁰⁶ *Id.* at 421.

¹⁰⁷ *Id.* at 422.

¹⁰⁸ *Id.* at 426.

The information in question concerned the possibility of losing management rights over two Australian mining projects. No investment could be lost, only the power to manage the projects if Texasgulf's partner in the venture so decided. The investments were only generally discussed in the 1972 *Texasgulf Annual Report* with no mention of the management agreement. In the company's 10-K filing with the SEC, the two projects were lumped with "other subsidiaries." 366 F. Supp. at 425 & n.77.

¹⁰⁹ *Id.* at 427.

¹¹⁰ *Id.* at 431-32.

¹¹¹ N.Y. Times, Sept. 13, 1973, at 73, col. 2.

¹¹² See No. 73-3137, 5th Cir., Sept. 13, 1973, unreported order on file with INDIANA LAW JOURNAL. See also N.Y. Times, Sept. 14, 1973, at 57, col. 2. The order was originally extended until December 1973, but the court granted CDC's motion for an expedited hearing and rescheduled it for October 10, 1973 (order on file with INDIANA LAW JOURNAL). See also N.Y. Times, Sept. 17, 1973, at 48, col. 6.

gulf announced a new ore strike¹¹³ and high earnings.¹¹⁴

On October 10, the court of appeals dissolved the restraining order.¹¹⁵ But, on October 13, the New York Stock Exchange suspended trading of Texasgulf stock because the price had been driven above the offer price and a dispute arose among tendering brokers and the CDC depository concerning the allowable time for withdrawal of tendered shares.¹¹⁶

The trial court clearly understood the necessity of keeping the shareholders informed as to matters arising during normal operations of their company and as to matters coming to light at the trial. However, since the original fault fell on management and since CDC was at all times willing to disclose, the court should have minimized its intervention, using a conditional injunction as a means of preserving its jurisdiction if CDC failed to comply adequately.

The intervention by the appellate court displays the method by which courts misplace sympathies and disregard the interests of the offeror and the shareholders. In so doing, the court denies not only the investment opportunity but also the complete dissemination of material information.

ADDITIONAL PROBLEMS IN FASHIONING INJUNCTIVE RELIEF

The *Texasgulf* case represents an ideal situation for the use of the conditional injunction discussed above. The offeror was clear about its willingness to disclose the information once the court decided disclosure was necessary. In addition, the offeror was willing to extend the tender offer in order to allow for sufficient dissemination of the new information. This willingness is a necessary precondition to the use of conditional injunctive relief. Where the offeror is not willing to make disclosure or to extend the tender offer, such a remedy would be inappropriate.

In the first place, there may not be sufficient time for dissemination of the required information before the scheduled expiration date of the tender offer. In addition, the offeror may not be willing to extend the expiration date because of market or other conditions extrinsic to the offer.¹¹⁷

¹¹³ N.Y. Times, Sept. 22, 1973, at 38, col. 3.

¹¹⁴ *Id.*, Oct. 6, 1973, at 33, col. 5.

¹¹⁵ No. 73-3137, 5th Cir., Oct. 10, 1973, unreported order on file with INDIANA LAW JOURNAL. See also N.Y. Times, Oct. 11, 1973, at 71, col. 2.

¹¹⁶ N.Y. Times, Oct. 13, 1973, at 54, col. 1; *id.*, Oct. 16, 1973, at 59, col. 7.

¹¹⁷ Such conditions may include a sudden upturn in the market, the announcement of a competing tender offer, the negotiation of a merger between the target and another

Secondly, the offeror may not be willing to disclose the information because it wishes to contest its materiality. This unwillingness may be simply a wish to avoid the costs of disseminating the new information unless and until the information's materiality is proven at a trial on the merits.

Alternatively, unwillingness to disclose may arise from the involvement of statutory or administrative limitations on corporate activity, such as licensing regulations or antitrust statutes that limit transfers of control. Such limitations often mean old information attains a new materiality.¹¹⁸ However, even though such information may potentially be material to an investor making an investment decision, the offeror may legitimately not wish to disclose until materiality is proven at trial on the merits. This may be because the offeror may expect litigation on the independent substantive issues alleged, such as a Sherman Act antitrust violation.¹¹⁹ Any litigant would naturally be hesitant to make available to the public all information, facts and theories in his possession concerning such charges.¹²⁰

company, or a major change in interest rates or margin requirements that would affect the financing of the offer. See notes 33, 37-40, 42 *supra* & text accompanying.

¹¹⁸ Owners assume their companies conduct their affairs within a regulatory framework and the precise boundaries of that framework are rarely relevant to the investment decision. However, when those boundaries are about to be breached and assets or opportunities thereby lost, the offeror should note the necessity to specify for the investor the nature of the boundaries and the loss to be incurred. See note 85 *supra*.

¹¹⁹ Cases arising under the Williams Act often allege an antitrust violation and a failure to disclose (under the Williams Act) that the successful consummation of the offer would create the antitrust violation. In such cases, a full trial on the merits of the antitrust allegation will be needed if the tender offer succeeds in causing a *de facto* merger of the two companies.

¹²⁰ The purpose of the Williams Act is the protection of investors, but the scope of that protection is not as broad as some courts would seem to prefer. The Act is framed in terms of disclosure and informed investor decisions rather than in terms of a catch-all source of authority for enjoining all potential adverse effects on the value of stock holdings. The Act was not meant to provide a bootstrap preliminary remedy if allegations of a substantive harm, *e.g.*, violations of the antitrust laws, were insufficient to support a preliminary injunction on their own merits. In other words, Williams Act injunctions should be used to enforce Williams Act purposes, not to enjoin all potentially unlawful actions. This principle was applied in *Missouri Portland Cement Co. v. Cargill, Inc.*, [Current] CCH FED. SEC. L. REP. ¶ 94,595 (2d Cir. June 10, 1974). In that case, both the district court and the appellate court found adequate grounds to issue injunctive relief on the basis of allegations of possible Clayton Act, section 7, 15 U.S.C. § 18 (1970), violations. (The district court enjoined the tender offer. The appellate court remanded with instructions to frame an injunction that would allow the tender offer to continue.) Both courts refused to enjoin the tender offer on grounds of failure to disclose the antitrust violations, finding that

it would not have been unreasonable for Cargill's management [the offeror] to have concluded after appropriate inquiry that no substantial antitrust obstacles stood in the way of its acquisition. Therefore, under the circumstances before us, the possibility that the acquisition would result in antitrust violations, a possibility that exists with every merger, need not have been disclosed to Missouri

In any of these cases of initial offeror unwillingness to extend the offer or unwillingness to disclose the information until trial on the merits, there may still be alternative remedies to full-fledged injunctions. Such alternatives should be less destructive of tender offers and more compatible with the finely tuned statutory balance of the Williams Act.

Most judges and commentators agree that the time of the initial petition is the best opportunity for the courts to exercise their equitable powers, but a conflict centers around whether equity should enjoin all potential injury or whether a practical appraisal should be made of discrepancies occurring in the heat of battle.¹²¹

If a court opts for the "heat of battle" theory and allows the tender offer to continue, pending a trial on the merits, it faces the task of reversing the takeover should management or objecting stockholders succeed in proving the illegality of the offer.¹²² The task of unraveling may be formidable, if not impossible, if the offeror has exercised control, made changes, created a situation of potential competitive restraint that is illegal per se under antitrust laws, or caused a transfer of control over a licensed right that is unlawful under the licensing statute. On the other hand, it would be equally impractical for a court to order consummation of a tender offer that was made unprofitable by the improvident granting of an injunction and disruption of the schedule.

These problems could be overcome by a preliminary injunction limited to enjoining consummation of the tender offer, but not enjoining the solicitation and collection of shares. The court's equitable powers could be used to order tendered stock into escrow, preventing the raider from exercising voting rights and control. Pendente lite beneficial ownership of the stock by the raider would not create a per se violation of the antitrust or licensing statutes that limit transfers of control of companies or privileges. This solution is neutral as between manage-

Portland's [the target's] shareholders.
Missouri Portland Cement Co. v. Cargill, Inc., *supra* at 96,095-25 n.44 (quoting the district court opinion).

¹²¹ Compare *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969) (preliminary injunction denied): "[T]he participants on both sides act, not 'in the peace of a quiet chamber,' [citing cases] but under the stresses of the market place," with *Sonesta Int'l Hotels Corp. v. Wellington Associates*, 483 F.2d 247 (2d Cir. 1973) (preliminary injunction granted):

Thus, in the *normal situation*, when it appears likely that the offer may contain materially misleading statements or omissions as made, the interest of the shareholders and of the public in full disclosure of relevant circumstances renders preliminary injunctive relief an appropriate method of remedying the deficiencies in disclosure before the offer is consummated.

Id. at 250-51 (emphasis added).

¹²² See *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969).

ment and the raider. However, tendering stockholders are left in the position of uncertainty of their sale. This situation is easily cured by an additional order allowing, but not requiring, the withdrawal of tendered shares.¹²³ Stockholders wishing to promote the success of the offer or wishing to reap the premium value could leave their shares with the bidder. Those stockholders with other needs would be able to recover their shares.

The benefits available from this proposed remedy will vary from case to case, but generally the offeror is saved the expense and time of reregistering and republicizing his tender offer. The offeror is also enabled to move swiftly to consummate the offer if the offeror is successful at a trial on the merits. A third benefit to the offeror is the limitation of management's defensive tactics if escrow-held shares cannot be voted to provide requisite shareholder approval.¹²⁴

The use of this remedy can be illustrated by reference to *Gulf + Western Industries v. The Great Atlantic & Pacific Tea Co.*¹²⁵ G + W, the offeror, sought to enjoin the target from violating section 14(e), alleging false and misleading statements and omissions of material facts. A & P counterclaimed for injunctive relief alleging omissions of material facts and possible antitrust violations if the tender offer were consummated.

A & P based its counterclaim on the alleged antitrust violations and violations of section 14(e) by failure to disclose G + W's intention to gain sufficient control of A & P to influence policies and failure to disclose G + W's other holdings and their possible antitrust implications. A & P alleged both horizontal and vertical anticompetitive effects arising primarily from Bluhdorn's interests in Bohack and possible subtle pressures for reciprocal dealing between G + W's other subsidiaries and suppliers to A & P. In a carefully reasoned opinion, the Second Circuit Court of Appeals found the antitrust implications to be adequate for the issuance of a preliminary injunction.¹²⁶ Following that

¹²³ The statute allows withdrawal of tendered shares until the expiration of seven days after *definitive* copies of the offer or request are first published or given to security holders. 15 U.S.C. § 78n(d)(5) (1970) (quoted in note 13 *supra*). However, no definition of "definitive" is given. Since the purpose of the enactment of the Williams Act was to make disclosure part of the offer, it would seem that the seven day withdrawal provision would not become operative until satisfactory disclosure (as part of the offer) is made.

¹²⁴ For example, shareholder authorization of management proposals may not be provided if the corporation's charter or by-laws require approval by two-thirds of the outstanding shares and more than one-third of the shares are held in escrow.

¹²⁵ 476 F.2d 687 (2d Cir. 1973). For a discussion of the facts and parties in this dispute see note 99 *supra*.

¹²⁶ 476 F.2d at 698-99. The court held that there was no right to proceed with a

finding, the court also decided that the antitrust problem was material and should have been disclosed.

The court was entirely correct in finding the necessity for disclosure of the potential antitrust implications, especially since the facts showed that the problem had been considered to be of some relevance by the offeror. However, since the bidder had attempted to overcome the problem and there was some likelihood that the attempt would have been successful, the court may have been better advised to simply order the stock into escrow, rather than stop the tender offer. This proposed remedy integrates well with the shareholder-protective scheme of the Williams Act. It provides the investor with the needed information and allows the shareholders the continued opportunity to make their own decisions.

It is impossible to fashion a universal remedy satisfactory to all parties concerned. However, all parties have a common interest in the quick resolution of the dispute and this interest should be recognized by the courts in striving toward the objective of minimizing the extent and duration of the courts' role in the offer.¹²⁷ As Judge Friendly said, citing a much higher authority, the court should "let the punishment fit the crime."¹²⁸

CONCLUSIONS

Recent court decisions have apparently lost sight of the purposes and intent of the Williams Act, as a part of the entire plan of securities law, to protect investors by requiring disclosure of material information. The intent of the Williams Act was not to eliminate tender offers or the market for corporate control, but to allow investors the opportunity to make informed investment decisions based on adequate information in a free and open market.

Various areas of the securities law, regulations, and stock exchange rules require disclosure of information by management. Tender offer disclosure requirements should be viewed in context with these other requirements to avoid unnecessary duplication of information and to avoid shifting all disclosure burdens from management to the tender

tender offer unlawfully violating antitrust laws.

¹²⁷ FED. R. CIV. P. 65, which authorizes the issuance of injunctive relief, itself recognizes the need for quick resolution of a dispute. The rule requires priority in scheduling hearings if notice was not given before the issuance of a temporary restraining order and allows advancement and consolidation of the trial on the merits with the hearing on the injunction.

¹²⁸ *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969).

offeror. A viable standard would consider information previously judged, then disclosed or omitted, by management. The only new information required would be plans and proposals bearing a present intent of execution by the raider, some information about the raider if it is not publicly available, and explanations of the fact and consequences of ancillary regulatory restrictions that would not be known to the public and that would be relevant to the future operations and opportunities of the corporation under new control. Old information acquiring renewed importance and previously undisclosed information may be added to the offeror's burden if that is the only means for adequately protecting the investing public.

The purposes of the law could be better served if the courts were to relax their tendency to enjoin all offers and to fashion remedies more suitable to presenting information to the public without tipping the balance of interests to protect incumbent managements.

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